

TENNESSEE GENERAL ASSEMBLY
FISCAL REVIEW COMMITTEE



FISCAL NOTE

HB 1721 - SB 1977

March 2, 2014

SUMMARY OF BILL: Enacts the Equity for Entrepreneurs Act which authorizes franchise and excise (F&E) tax credits equal to \$5,000 for each new full-time employee job or capital investment of at least \$100,000 in real property, tangible personal property or computer software for any start-up small business that employs 50 or fewer full-time employees at the time of application and that is in the first 36 months of providing goods or services in the ordinary course of business at the time of application. Limits the total lifetime tax credits claimed by any one start-up small business to \$50,000.

ESTIMATED FISCAL IMPACT:

Decrease State Revenue – \$1,146,800/FY14-15
\$2,293,600/FY15-16
\$3,440,400/FY16-17 and Subsequent Years

Other Fiscal Impact – Additional economic impacts may occur as a result of this bill. However, due to many unknown factors, fiscal impacts directly attributable to secondary economic impacts cannot be quantified with reasonable certainty.

Assumptions:

- Based on United States Bureau of the Census Business Dynamics Statistics Data, it is estimated that approximately 12,000 new businesses are created in Tennessee each year. Approximately 20 percent of such businesses, or 2,400 (12,000 x 20.0%), are estimated to be new businesses, not new locations of existing firms.
- A 2010 NBER paper by Robb and Robinson, *The Capital Structure Decision of New Firms*, reports that 44.5 percent of observed new businesses surviving the three-year period of 2004 – 2007 reported a profit. Further, 58 percent of businesses structure themselves with some type of limited liability and therefore are subject to F&E taxes.
- As a result, it is estimated that 619 businesses will report profit and be subject to both franchise and excise taxes (2,400 x 44.5% x 58.0%).
- The referenced paper further reports the profit categories for surviving businesses. Based on such information, it is estimated that: 63 of the 619 businesses will recognize an average profit of \$500; 101 businesses will recognize an average profit of \$2,500; 77

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businesses will recognize an average profit of \$7,500; 108 businesses will recognize an average profit of \$17,500; 124 businesses will recognize an average profit of \$62,500; and 25 businesses will recognize an average profit of \$200,000. The remaining 121 businesses will recognize profits close to zero and their F&E tax liability is estimated to be minimal.

- Assuming a 6.5 percent excise tax rate, the total excise tax liability for such businesses is estimated to be \$1,007,598 per year $[(63 \times \$500 \times 6.5\%) + (101 \times \$2,500 \times 6.5\%) + (77 \times \$7,500 \times 6.5\%) + (108 \times \$17,500 \times 6.5\%) + (124 \times \$62,500 \times 6.5\%) + (25 \times \$200,000 \times 6.5\%)]$.
- Assuming 1,392 businesses (2,400 new businesses x 58.0% subject to franchise tax) pay an average of \$100 in franchise tax, the franchise tax liability is estimated to be \$139,200 (1,392 x \$100).
- The total annual F&E tax liability for businesses that will be impacted by the bill is estimated to be \$1,146,799 (\$1,007,599 + \$139,200).
- It is estimated that on average an addition of one full-time employee for which the tax credit can be claimed will remove the entire F&E tax liability for qualifying businesses. Therefore, the total annual decrease in state revenue is estimated to be \$1,146,799.
- Since small businesses are eligible to receive credits for three years, the decrease in state revenue is estimated to be: \$1,146,799 in FY14-15, \$2,293,598 in FY15-16 (\$1,146,799 x 2), and \$3,440,397 in FY16-17 and subsequent years (\$1,146,799 x 3).
- There could be subsequent impacts to state and local governments as a result of this bill. However, due to many unknown factors, such as the number of jobs created as a direct result of this bill that would not be created in the absence of the tax credit, wages and spending habits of new job holders, and the extent of taxpayer savings that will be re-spent in Tennessee on taxable goods and services, any such impacts cannot be quantified with reasonable certainty.

IMPACT TO COMMERCE:

Decrease Business Expenditures – Net Impact –

Exceeds \$1,000,000/FY14-15

Exceeds \$2,100,000/FY15-16

Exceeds \$3,200,000/FY16-17 and Subsequent Years

Jobs Impact – Not Significant

Assumptions:

- Assuming a small increase in wage expenditures for qualified small businesses for adding additional full-time jobs, and taking into account reduced tax liabilities as a result of receiving tax credits, it is estimated that the net decrease in business expenditures will exceed: \$1,000,000 in FY14-15, \$2,100,000 in FY15-16, and \$3,200,000 in FY16-17 and subsequent years.

- The impact on private sector jobs cannot be determined with reasonable certainty as it is unknown how many new jobs will be created as a result of the proposed tax credit that would not be created under current law in the absence of such credit. However, any such impact is estimated to be not significant.

CERTIFICATION:

The information contained herein is true and correct to the best of my knowledge.

A handwritten signature in black ink, appearing to read "Lucian D. Geise". The signature is fluid and cursive, with the first name "Lucian" written in a larger, more prominent script than the last name "Geise".

Lucian D. Geise, Executive Director

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